In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 544

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LINCOLN SAVINGS AND LOAN ASSOCIATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE COMMISSIONER

The purpose of this reply is to point out the critical errors that underlie respondent's contention that the issue here lacks administrative or fiscal significance.

1. Respondent rests its entire argument with regard to the administrative significance of this case on Section 1312(7)(C)(iii). In reliance on that provision, respondent contends (Br. 7–10) that it would be unnecessary for savings and loan associations which have claimed current deductions for Section 404(d) payments to file protective claims for refund for later years in order to be assured of obtaining at least one deduction. This contention (summarized in point 2, Br. 9–10) is incorrect. Section 1312(7) applies only if, in the language of the pertinent regulations, "the determination establishes the basis of property" and

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an error occurred "in respect of a *prior transaction* upon which such basis depends, or in respect of a *prior transaction* which was erroneously treated as affecting such basis * * *." (Emphasis supplied.) Treasury Regulations on Income Tax (1954) Code), Section 1.1312–7(a). The basis "determination" involved in this and the 2,487 similar cases now pending is for taxable years in the 1960's. With regard to this "determination," there is no "prior transaction" to which Section 1312(7) could apply.[1] Under the government's theory of the case, Section 404(d) payments could be deducted only in *subsequent* taxable years (beginning in 1970). Thus, respondent and other similarly situated associations could not rely on Section 1312(7) to lift the bar of the statute of limitations for the later years and would be required to file protective claims for those years, with the resulting serious administrative difficulties described in our petition (Pet. 9–11).[2]

[1] That Section 1312(7) applies only to a basis error in a taxable year preceding the year of the "determination" is made clear not only by the regulations discussed above but by the unequivocal language of the statute itself. Section 1312 (7)(C) refers to the "PRIOR ERRONEOUS TREATMENT" and serves to lift the bar of the statute of limitations for the prior year in which the basis error was made. It does not reopen a subsequent taxable year otherwise closed by the statute where, as in this case, the basis error occurs in the earlier year in which the determination is made. The portion of the Senate Finance Committee report quoted by respondent (Br. 8–9) assumes that the taxpayer filed a timely claim for the later year.

[2] In points 1, 3 and 4 of its brief (Br. 9–10), respondent refers to three other possible situations that may arise in connection with the Section 404(d) payments. These are straw issues as to which no claim was made in the petition, and

These difficulties will continue even if the Fifth Circuit affirms the district court's decision for the taxpayer in *Washington Fed. S. & L. Ass'n of Miami Beach* v. *United States*, 304 F. Supp. 1072 (S.D. Fla). Respondent states (Br. 19) that, in this event, "it is to be hoped that the Internal Revenue Service would remove further difficulty by a sensible administrative promulgation." By this, respondent presumably means that the Service should thereafter subscribe to the rule adopted by the Ninth Circuit below. But, as we show in our petition (Pet. 10–11), no "sensible administrative promulgation" can solve the problem, because, even if the Service decides to follow the Ninth Circuit's rule, there can be no assurance that all savings and loan associations will do so. The uncertainty engendered by the possibility of additional litigation—regardless of what position the Service takes—and the consequent need for filing protective claims will continue until this Court provides a controlling solution.

2. In its opening argument (Br. 4–7), respondent points out that, under the government's theory, deductions will be allowed in 1970 and immediately succeeding years. From this, respondent concludes that the case lacks fiscal significance because the government's revenue loss will be substantial in the early 1970's irrespective of the ultimate resolution of the Section 404(d) payment problem.

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which have no bearing on the administrative problems discussed therein. The critical point is that respondent has erred in asserting that it and other taxpayers similarly situated could avoid filing protective claims in reliance on Section 1312(7).

Respondent is saying no more than that the question here is one of the proper timing of deductions—a fact noted in our petition (Pet. 8)—rather than one of whether a deduction should be allowed at all. In the present context, however, the timing problem alone involves substantial amounts of revenue.[3] That problem cannot be dismissed on the ground, suggested by respondent (Br. 7), that the government might have had to borrow at higher than the statutory six percent rate in the open market, in order to finance operations. In appraising the fiscal significance of the timing aspect, the open market rate—whether higher or lower than six percent—is irrelevant. What is relevant is whether the government was entitled to the funds in the first instance at no cost at all, and, for this purpose, the full amount of interest in dispute is to be taken into account.

Respectfully submitted.

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[3] The 22 million dollars of interest on presently pending claims is only a fraction of what ultimately will be involved. As explained in the petition (pp. 8–9), additional interest liability will arise with respect to claims not yet filed for prior years and with respect to future years.

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